Supreme Court of the United States

October Term, 1939

No. 1040 101

HENRY F. DU PONT, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PERCY W. PHILLIPS,
Attorney for Petitioner.

May, 1940.

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Henry F. du Pont, petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on February 28, 1940, affirming the decision of the United States Board of Tax Appeals.

Opinions Below

The opinion of the Board of Tax Appeals (R. 209) is reported in 38 B.T.A. 1317. The opinion of the Cir-

cuit Court of Appeals (R. 259) is reported in 110 F. (2d) 641.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 28, 1940 (R. 259). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

Whether a gain derived upon the sale of 62,500 shares of the common stock of Du Pont Company, or upon the sale of 40,500 of such shares, was gain from the sale of capital assets or was gain from a short sale.

Statute Involved

Revenue Act of 1932, c. 209, 47 Stat. 169 (Public No. 154; Seventy-second Congress):

> SEC. 101. CAPITAL NET GAINS AND LOSSES.
>
> (a) *Tax in Case of Capital Net Gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total

tax shall be this amount plus 12½ per centum of the capital net gain.

* * * * *

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

* * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years * * *.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

(s) *Limitation on Stock Losses—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

Statement

Despite the voluminous documentary record, the facts are very simple.

The petitioner, in 1932, was heavily indebted to the Bankers Trust Company in New York which demanded that he either deposit more collateral or reduce his debt. Included in the collateral for said debt were 62,500 shares of the common stock of E. I. du Pont de Nemours & Company (hereafter referred to as "Du Pont Company"). The petitioner made arrangements

with the Trust Company whereunder he would be allowed to withdraw said 62,500 shares of Du Pont Company common stock from his collateral, if he reduced his loan with the Trust Company by $2,000,000. [Stipulation, ¶¶ 11, 12, 13, 14; Exs. N to Q; R. 25, 26, 27, 179 to 183]. Said stock had been owned by the petitioner for more than two years. [Stipulation, ¶¶ 39, 47; Ex. A2 of Ex. C; R. 41, 45, 77.]

Petitioner entered into a contract with Christiana Securities Company whereby he agreed to sell it 62,500 shares of Du Pont Company common stock for $2,000,000, and thus acquire the money to pay to the bank. Christiana Securities Company arranged with J. P. Morgan & Company in New York to receive the stock for it and pay $2,000,000. [Stipulation, ¶¶ 15 to 18; Ex. U; R. 27, 28, 187.]

Petitioner requested his broker, Ellis, associated with the brokerage firm of Laird, Bissell & Meeds, who had offices in Wilmington and in New York, to carry out the details of the transaction. Ellis had the New York office of the brokers pay $2,000,000 to the Bankers Trust Company of New York on April 21, 1932, for the account of the petitioner, whereupon said Bankers Trust Company delivered to the brokers 62,500 shares of petitioner's stock of Du Pont Company. On the same day this stock was transferred from the name of petitioner to the name of the brokers, whereupon the New York office of said brokers delivered 62,500 shares of the stock of Du Pont Company to J. P. Morgan & Company, for the account of Christiana Securities Company, receiving payment of $2,000,000 therefor. Of the stock so delivered, 40,500 shares were out of

the certificates of the stock of the petitioner previously received by the brokers on the same day from Bankers Trust Company. [Stipulation, ¶¶ 19, 20; Ex. S; R. 28, 29, 30, 185].

Ellis had instructed the New York office of the brokerage firm that the stock delivered to Morgan & Company should not be stock of the petitioner, but should be borrowed stock. The instructions of Ellis with respect to delivery of borrowed stock were not followed, except with respect to 22,000 shares which were borrowed by the brokers and delivered to Morgan & Company. As to 40,500 shares, deliveries were made by the brokers of the stock which the petitioner had previously owned for a period of more than two years and which had been held in the Bankers Trust Company account. The transaction was recorded upon the accounts and books of the brokers as a short sale of borrowed stock by petitioner to Christiana Securities Company and a delivery by petitioner to the brokers of the "long" stock from Bankers Trust Company. The fact that the "long" stock of the petitioner was used in making delivery was either not known or was ignored in the accounting procedure.

The Commissioner of Internal Revenue and the Board of Tax Appeals held that the profit from the sale of all of said 62,500 shares of the stock of Du Pont Company was realized upon a short sale of stock, and was not realized upon the sale of the stock which petitioner had held for more than two years. The decision of the Board of Tax Appeals was affirmed by the Circuit Court of Appeals. Said decisions were based upon the intention of Ellis and upon the entries made upon

the books of account and ignored the actual facts of the transaction which took place. The rate of tax upon gains from the sale of capital assets held for more than two years is less than the tax upon the gain from short sales of stock.

Specification of Errors to be Urged

The Circuit Court of Appeals erred:

1. In holding that the gain realized by the petitioner from the sale of 40,500 shares of the stock of Du Pont Company was not subject to tax as capital gain, but was subject to tax at normal and surtax rates.

2. In the alternative to (1) above, in holding that the gain realized by the petitioner from the sale of 62,500 shares of the stock of Du Pont Company was not subject to tax as capital gain, but was subject to tax at normal and surtax rates.

Reasons for Granting the Writ

Section 101 of the Revenue Act of 1932, *supra*, provides for the taxation of gain from the sale of capital assets at special rates of tax. Section 23 (s) of that Act, *supra*, provides that such special rates shall not apply to gains from short sales of stocks. In this case the rate of tax depended upon whether or not there had been a short sale which, in turn, depended upon whether or not the sale was completed by delivery of borrowed stock or by delivery of stock owned by the petitioner. The record showed that on the books of account of the broker and of the petitioner the transaction was recorded as a short sale, but also showed

that the actual transaction was not a short sale. Of 62,500 shares sold and delivered, 40,500 shares delivered to the purchaser were from the long stock which had been owned by the petitioner for more than two years, and only 22,000 shares were borrowed. In determining that there had been a short sale of 62,500 shares, the Court below gave effect to the intention of the broker to effect a short sale and to the bookkeeping entries recording a short sale, and failed to give effect to the actual transaction. Such decision is in conflict with decisions of this Court, and with certain decisions of the Circuit Courts, announcing the principle that neither intention nor bookkeeping entries can prevail over the actual transaction in determining what shares of stock are involved in a sale.

In a case involving the same principle, *Davidson* v. *Commissioner*, 305 U. S. 44, this Court held that tax liability on the sale of stock was governed by the stock delivered and not by the intention or instructions of the owner to deliver other stock. In that case the owner had instructed his bank to deliver certain certificates of stock upon a sale. The bank delivered other certificates which had a different basis for tax liability. The Court held that the tax liability was to be determined by the stock actually delivered, regardless of intent or instructions.

That case is on all fours with the present case. Although cited in briefs, it was ignored by the Circuit Court in its decision.

To the same effect is *Doyle* v. *Mitchell Brothers*, 247 U. S. 179.

This instant decision is also in conflict with *Ruml* v. *Commissioner*, 83 F. (2d) 257 (CCA-2); *Huntington National Bank* v. *Commissioner*, 90 F. (2d) 876 (CCA-6); *Commissioner* v. *Dashiell*, 100 F. (2d) 625 (CCA-7).

In deciding the instant case, the Circuit Court treated the issue as one of first impression. It cited no authorities for its decision. It ignored the decisions of this Court in *Davidson* v. *Commissioner*, *supra*, and *Doyle* v. *Mitchell Brothers Co.* It ignored the decisions of other circuits in somewhat similar circumstances.

In similar circumstances, this Court granted certiorari. *Deputy* v. *du Pont*, 308 U. S. 488, where this Court said:

> "We granted certiorari because of the asserted inconsistency of that ruling [decision of Third Circuit Court of Appeals] with *Welch* v. *Helvering*, 290 U. S. 111, and with *Burnet* v. *Clark*, 287 U. S. 410."

It is respectfully submitted that this petition should be granted.

PERCY W. PHILLIPS,
Attorney for Petitioner.

May, 1940.